

IT 01-9

Tax Type: Income Tax

Issue: Restricted Interest

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**"SPECIFIC AUTOMOTIVE INC.",
Taxpayer**

No. 99-IT-0000
FEIN: 00-0000000
Tax yr.: 1985

Charles E. McClellan
Administrative Law Judge

RECOMMENDATION FOR DECISION

Appearances:

Ralph Bassett and Deborah Mayer, Special Assistant Attorneys General, for the Department of Revenue; David A. Hughes of Horwood, Marcus & Berk for the taxpayer.

Synopsis:

This matter involves a protest to a Notice of Deficiency issued to "Specific Automotive, Inc." (taxpayer) by the Department of Revenue (Department) on May 28, 1999. The Notice of Deficiency assessed restricted interest¹ for the 1985 tax year² calculated on the amount of tax due prior to the application of Illinois net loss deductions carried back from 1986 and 1987. The parties filed a stipulation of facts in which the

¹ The term *restricted interest* is not defined in the Illinois Income Tax Act. However, a term not defined in the Illinois Income Tax Act has the same meaning as it has in the federal Internal Revenue Code (IRC) when used in a comparable context, as the phrase *restricted interest* is in this case. 35 ILCS 5/102. IRC § 6601(d)(1) defines the term as being interest computed for a limited period of time when there is a net operating loss carryback that restricts the period for calculating interest on an earlier liability.

taxpayer waived its right to an evidentiary hearing. Both parties filed briefs. I recommend that the Notice of Deficiency be made final.

Finding of Facts:

1. Taxpayer is a Delaware corporation with its corporate domicile in the State of (Someplace). Stip. ¶ 1³
2. The Department issued a Notice of Deficiency to Taxpayer on May 28, 1999 and attached thereto was a document entitled *Computation of Erroneous Refund* and related amended EDA-25s.⁴ Stip. ¶ 2; Group Ex. No. 1
3. Taxpayer timely filed a protest to the Notice of Deficiency on July 26, 1999. Stip. ¶ 3; Group Ex. No. 2
4. In March of 1997, the Department and taxpayer, together with certain of its subsidiaries, entered into an income tax settlement agreement (settlement) for the tax years ending December 31, 1983 through and including December 31, 1989 resulting in a reduction of the tax liability for taxpayer and a subsidiary, "Specific Automotive Finance Co.", of \$10,000,000 for the audit period. Group Ex. No. 3
5. The settlement was documented on eleven IL-870-AD forms⁵ signed by the parties. Ex. Nos. 10 – 20

² Taxpayer files its income tax returns on a calendar year basis.

³ The stipulation is cited as *Stip. ¶* __. Exhibits attached to the stipulation are cited as *Ex. No.* __.

⁴ An EDA-25 is a Department form entitled *IL 1120 Auditor's Report*. It sets forth the taxpayer's income and tax before the Department adjustments and the income, tax, penalties, interest and deficiency after taking the adjustments into account.

⁵ An IL-870-AD form is Department of Revenue form entitled *Offer of Waiver of Restrictions on Assessments and Collection of Deficiency in Tax and Acceptance of Overassessment*. When signed by the taxpayer and the Director, it is the document that is used to conclude income tax controversies at the administrative hearing level.

6. The settlement resolved Notices of Deficiency issued by the Department to the taxpayer and its affiliates for the 1983-1989 tax years and the protests timely filed for those years. Stip. ¶ 4
7. The Department executed these IL-870-ADs for the 1983-1989 tax years without any fraud, malfeasance, concealment, or misrepresentation of material fact by taxpayer. Stip. ¶ 5
8. The amounts shown on these IL-870-ADs reflect adjustments to tax only and do not include interest. Stip. ¶ 6
9. On December 31, 1996, in preparation for the settlement, the Department prepared a document entitled *Memorandum and Summary of Legal Settlement Amounts*. Stip. ¶ 7; Ex. No. 3
10. On December 31, 1996, the Department also prepared an EDA-25 for taxpayer pertaining to its 1985 tax year reflecting the tax due prior to the amended income tax return (Form IL-1120-X) filed by taxpayer on February 25, 1993 to reflect adjustments made by an Internal Revenue Service auditor to taxpayer's federal income tax returns. Stip. ¶ 8; Ex. No. 4
11. Further, on December 31, 1996, the Department prepared a second EDA-25 for taxpayer's 1985 tax year for the restricted interest that accumulated until January 14, 1989, the date taxpayer filed an IL-1120-X reflecting the carry back of its 1987 Illinois net loss. Stip. ¶ 9; Ex. No. 5
12. Finally, on December 31, 1996, the Department prepared a third EDA-25 for taxpayer's 1985-tax year reflecting the reduction in tax liability by \$522,444 as agreed to in the settlement. Stip. ¶ 10; Ex. No. 6

13. A refund check was issued to the taxpayer for the 1985 tax year (Warrant # TD0000000, dated June 26, 1997) in the amount of \$423,687.95. This payment represented a tax refund of \$322,799 and accrued interest in the amount of \$100,888.95. Stip. ¶ 11
14. The Department determined that the refund payment (Warrant # TD0000000, dated June 26, 1997) was incorrect in that it failed to reflect the “restricted interest.” Stip. ¶ 12
15. The Department prepared three additional EDA-25 forms, all dated May 25, 1999, in order to correct the error. Stip. ¶ 13
16. The first EDA-25, completed on May 25, 1999, captures the account status before any loss applications and begins the calculation with January 14, 1989 and reflects the changes made by taxpayer’s February 25, 1993 amended return. Stip. ¶ 14; Ex. No. 7
17. The second EDA-25, completed on May 25, 1999, captures the account status after the first claim date but before the second claim date (interest computed through 1/31/90 claim date) and reflects a decrease in the tax of \$494,890 due to the filing of an amended return to reflect the Illinois net loss deduction for the 1986 tax year. Stip. ¶ 15; Ex. No. 8
18. The third EDA-25, completed on May 25, 1999, captures the account status after the first claim date but before the second claim date (interest has been computed through 6/6/97 refund date) and reflects a decrease in the tax of \$334,410 due to the filing of an amended return to reflect the Illinois net loss deduction for the 1987 tax year. Stip. ¶ 16; Ex. No. 9

19. The restricted interest, interest that accumulated on the account prior to the reduction in tax due to the application of the two Illinois net loss deductions, was recalculated on the EDA-25s (Ex. Nos. 7, 8, and 9) and it was determined to equal \$236,121. This amount combined with additional interest, payments and refunds resulted in the excess refund of \$304,944 assessed on the Notice of Deficiency. Stip. ¶ 17; Group Ex. No. 1

Conclusions of Law:

This matter involves restricted interest assessed for the year 1985 in a Notice of Deficiency issued to the taxpayer on May 28, 1999. The restricted interest is interest calculated on a deficiency incurred by the taxpayer for 1985 prior to reduction of the deficiency by Illinois net loss deductions carried back from the years 1986 and 1987. The deficiency was incurred as the result of the Department's audit of the taxpayer and its affiliates for the years 1983 through 1989. The Department issued Notices of Deficiency for the assessments which the taxpayer protested.

The taxpayer and the Department settled the issues protested by agreeing to a net reduction of \$10,000,000 in the tax liability of taxpayer and "Specific Automotive Finance Corp." The settlement was reflected on eleven IL-870-AD forms that the taxpayer signed on March 11, 1997 and the Director signed on March 13, 1997. The IL-870-AD forms only reflect tax, not interest. Upon the execution of the IL-870-AD forms, the Department issued checks to taxpayer, including a check dated June 26, 1997, for the 1985 tax year in the amount of \$423,687.95. This check included tax of \$322,799 and interest of \$100,888.95.

Taxpayer incurred Illinois net losses for 1986 and 1987 for which it filed amended returns on January 14, 1989 and January 31, 1990, respectively, to carry back the losses to 1985. On May 28, 1999, the Department issued the Notice of Deficiency at issue assessing restricted interest calculated on the taxable income amount prior to adjustment for the net loss deductions from the date of underpayment through the claim dates.

The issue to be decided in this case is whether the Illinois Income Tax Act⁶ or the IL-870-AD forms executed by the taxpayer and the Department on March 11 and 13, 1997, respectively, for the 1985 tax year, preclude the Department from assessing taxpayer for the restricted interest for the 1985 tax year that is reflected on the May 28, 1999 Notice of Deficiency.

The Department's *prima facie* case was established in this case by the introduction into evidence, by stipulation, a copy of the Notice of Deficiency under the certificate of the Director. 35 ILCS 5/914; Balla v. Dept. of Revenue, 96 Ill. App.3d 293 (1st Dist. 1981). If there are factual issues in a case, the taxpayer must present consistent and probable evidence identified with its books and records to overcome the Department's *prima facie* case. Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). There are no factual issues in this case, however. The sole issue involves the construction of the language in the Department's IL-870-AD form for the assessment of interest on deficiencies.

The language on the form IL-870-AD that is involved in this case and that is key to the resolution of the issue, in relevant part, provides as follows:

Pursuant to Section 907 of the Illinois Income Tax Act, the undersigned waives the restriction provided in Section

⁶ Unless otherwise noted, all statutory references are to 35 ILCS 5/101, *et seq.*, the Illinois Income Tax Act ("IITA" or the Act).

903(b) of the Illinois Income Tax Act and consents to the immediate assessment and collection of the following deficiencies (increase in tax and penalties) with interest as provided by law. [emphasis added.] Ex. Nos. 10-20

IITA § 907 provides as follows:

Waiver of Restrictions on Assessment. The taxpayer at any time, whether or not a notice of deficiency has been issued, shall have the right to waive the restrictions on assessment and collection of the whole or any part of any proposed assessment under this Act by a signed notice in writing filed with the Department in such form as the Department may by forms or regulations prescribe. 35 ILCS 5/907.

Taxpayer's first argument is that the Notice of Deficiency for the restricted interest violates the settlement agreement for the 1985-year as reflected in the IL-870-AD forms. Taxpayer states correctly that for the years 1983-1989 the taxpayer and the Department agreed to a reduction of \$10,000,000 in income and replacement tax for "Specific Automotive" and its affiliates. This settlement agreement was reflected in the eleven IL-870-AD forms that both parties signed.

Taxpayer argues that the language of the IL-870-AD form bars the Department from assessing the restricted interest. The language relied on by the taxpayer is the language that provides that, "the case shall not be reopened in the absence of fraud, malfeasance, concealment or misrepresentation of a material fact, or important mistake in mathematical calculation, except that the case shall be subject to being reopened to reflect a federal change or alteration, whether resulting in an increase or decrease in Illinois income tax liability." Taxpayer argues that the Department's assessment of restricted interest does not fall within any of the situations listed in the quoted language, so the Department is barred from assessing it at this time. There is, however, no issue of whether the restricted interest assessment comes under one of these exceptions. The issue in this

case relates to the clause in the form that provides that assessment is “with interest as provided by law.” Therefore, the taxpayer’s argument is inapposite.

There are no Illinois cases that address the issue of whether the Department is barred from assessing restricted interest by a previously signed IL-870-AD. However, the Internal Revenue Service uses a form to conclude cases at the appellate level, the 870-AD that is substantially the same as the Illinois form IL-870-AD. The federal form contains language identical to the IL-870-AD with regard to interest. After reciting that the taxpayer consents to the assessment of tax and penalties, if any, both forms add the phrase, “with interest as provided by law.” Therefore, federal cases addressing this issue are helpful. See Kroger Company v. Department of Revenue, 284 Ill.App.3d 473, 481. (1st Dist. 1996)

In a case involving federal income tax, the U.S. Claims Court has held that an 870-AD does not bar the subsequent assessment of restricted interest. Decisionone Holdings Corporation v. United States, 1996 U.S. Claims LEXIS 201, 97-1 U.S. Tax Cas. (CCH) ¶ 50,110 (Ct.Cl. 1996) (The silence of Form 870-AD regarding restricted interest indicates that the executed Form 870-AD does not preclude the government from collecting restricted interest.) The same result has been reached when the case is closed with a settlement agreement, on a form other than an 870-AD, which does not specify the amount of interest due. Spendthrift Farm, Inc v. U.S., 931 F.2d 405 (6th Circ. 1991) (while there is no “magic words” requirement, for the closing agreement to cut off the IRS’ claim for restricted interest there must be a specific waiver in the closing agreement.) Because the Department follows the federal practice for assessing restricted interest and the language used in the IL-870-AD with regard to interest is identical to that used in the federal 870-

AD, the interpretation given this language in the federal cases must also apply in the instant case.

As the Department points out in its response, the IL-870-AD form only specifies tax and penalties as being the subject matter of agreement. The only mention of interest in the entire form is in the phrase that specifies that the specified liabilities to which it applies are, “the following deficiencies (increase in tax and penalties) with interest as provided by law.” Interest is not one of the specified items, but it is clearly provided for by law at 35 ILCS 5/1003. The language in the IL-870-AD, as in the federal 870-AD, makes it clear that interest is yet to be calculated as provided by statute, and thus, the assessment of restricted interest in this case is not barred by the IL-870-AD signed by the taxpayer.

Taxpayer next argues that, to the extent that the Department may assess restricted interest, it is limited to assessing no more than the amount of interest originally paid by the Department to the taxpayer. Taxpayer argues that because the settlement reached for the 1983-1989 years included interest paid to the taxpayer in the amount of \$100,888.95, the Department is limited in its assessment to that amount. Taxpayer argues that if the Department assesses more than that amount, it is attempting to recoup tax for 1985 that is in excess of the amount agreed to in the settlement. Taxpayer’s argument, for which it cites no authority, is incorrect because it mixes wholly separate statutory concepts.

The interest included in the payment made to the taxpayer reflecting the settlement represented in the IL-870-AD forms was interest owed by the Department to the taxpayer on an overpayment. It is prescribed by IITA § 909(c). 35 ILCS 5/909(c). The restricted interest assessed by the Department in the Notice of Deficiency at issue is interest owed to the Department on the tax liability for 1985 prior to the reduction of the

base income on which it was calculated by the net Illinois loss carrybacks. This interest is prescribed by IITA § 1003. 35 ILCS 5/1003. There is no correlation or relationship between these two statutory provisions. There is no provision limiting interest assessed by the Department under IITA § 1003 to the amount previously paid to the taxpayer under IITA § 909(c). Therefore, the Department's assessment of restricted interest is not limited to the interest previously paid to the taxpayer.

For the reasons set forth above, I recommend that the Notice of Deficiency be made final.

ENTER: September 18, 2001

Administrative Law Judge